Economic Trends

Low oil prices slowing Alberta economy

Low oil prices continue to weigh on Alberta's economy. A deteriorating labour market has led to a pullback in consumer spending. Manufacturing activity has declined and, despite strong crude production growth, lower oil prices are pulling down the value of exports. This month's InFocus analyzes the impact of the economic slowdown on costs in the province.

Indicator	Latest Month	Value	Change year-over-year (y/y)
Employment (thousands)	October	2,304	+0.6%
Unemployment Rate	October	6.6%	+2.2 p.p.
CPI Inflation (unadjusted)	October	1.4%	-1.6 p.p.
Retail Sales	September	$6.3 B	-5.6%
Housing Starts (annualized)	October	31,770	-22.8%
Rigs Drilling (unadjusted)	October	115	-56.8%
Manufacturing Shipments	September	$8.7 B	-15.3%
Exports (unadjusted)	September	$8.0 B	-25.7%

Source: Statistics Canada, CAODC, CMHC. p.p.= percentage points.

Alberta Household Sector

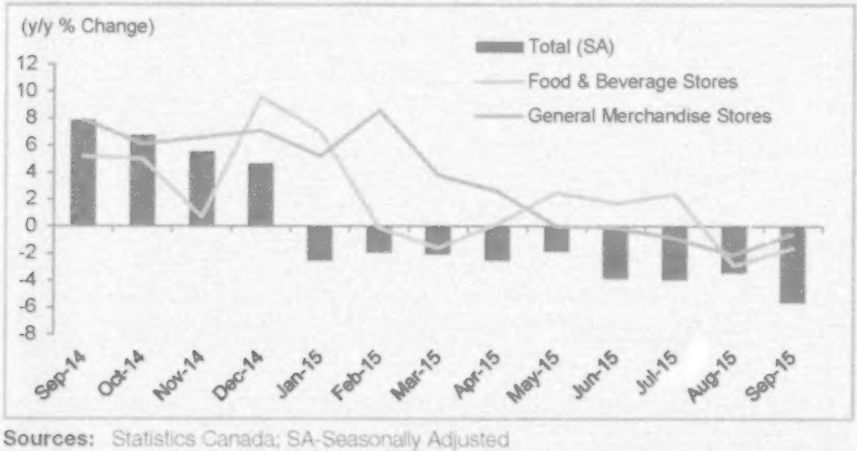
Labour market slowing

Alberta's labour market is cooling. After holding steady for most of 2015, employment dropped sharply in October by 10,800. Most losses were in the goods sector, including construction, manufacturing, and oil and gas. The unemployment rate reached 6.6% in October, the highest rate since July 2010. Employment insurance claims and beneficiaries are elevated, with claims up by 49% year-to-date (YTD) and beneficiaries reaching over 57,000 for the first time since January 2010. Job vacancies have declined to under 32,000 in the province from the recent peak of over 52,000 in October 2014.

Downturn in earnings

Despite edging up in September, average weekly earnings (AWE) have fallen 2.8% since the beginning of the year, and are up only 0.3% YTD. AWE in the goods sector have remained below last year's level for the past six months, mainly on declines in mining, oil & gas and construction. Earnings have also softened in the professional, scientific and technical services sector, which is closely tied to the energy industry. In contrast, growth in service sector earnings has stayed positive. AWE has been impacted by lower average weekly hours, which have fallen 1.6% YTD, and from layoffs in higher paying industries linked to the oil and gas industry.

Chart 1: Non-discretionary spending trending lower
Alberta Retail Sales



Sources: Statistics Canada; SA-Seasonally Adjusted

Spending continues to retreat

The deteriorating labour market conditions are impacting consumer spending. Retail sales were down 3.0% over the first three quarters of 2015, compared with the same period last year. While the pull-back in spending was at first isolated to larger purchases, such as new motor vehicle sales (-11% YTD), it has since spread to non-discretionary spending (Chart 1). Spending at food and beverage stores has fallen for the past two months, while spending at merchandise stores has fallen in the past four months. Gasoline station sales have declined faster than prices, indicating that Albertans are also curbing their driving.

Housing market softening

Housing market activity has progressively slowed through 2015. After a strong first quarter, housing

starts have moderated and are down 7.5% over 10 months of the year. Single-family starts have declined 22% YTD and remain significantly lower than the 5-year average. As a result, new housing price growth fell from 3.6% in December to -0.3% in September. The resale market has not picked up after plunging at the beginning of the year. Existing home sales and new listings have been relatively stable, albeit at much lower levels. The reduced activity has caused prices to fall 2.0% YTD.

Alberta Business Sector

Livestock boosts farm receipts

Farm cash receipts totalled just over $10 billion over the first three quarters of the year, recording growth of 6.3%. Receipts were led by a 10% YTD gain in livestock, as livestock prices jumped over 20% in the first six months of 2015. Crop receipts held steady at last year's level, despite challenging growing conditions in 2015.

Sweeping manufacturing declines

After peaking in June, Alberta manufacturing sales declined in the third quarter. They fell to $5.7 billion in September, the lowest in four years. Most categories saw declines. Lower fuel prices caused the value of petroleum and coal shipments to fall by 36% YTD. The downturn in drilling across North America has dampened demand for Alberta-made machinery and equipment; sales were down by almost 20% YTD. Bucking the overall trend, food manufacturing continued to increase, up 9.1% YTD (Chart 2). Chemical products have posted slightly lower sales values so far this year; however, volumes appear to have increased by almost 4% YTD.

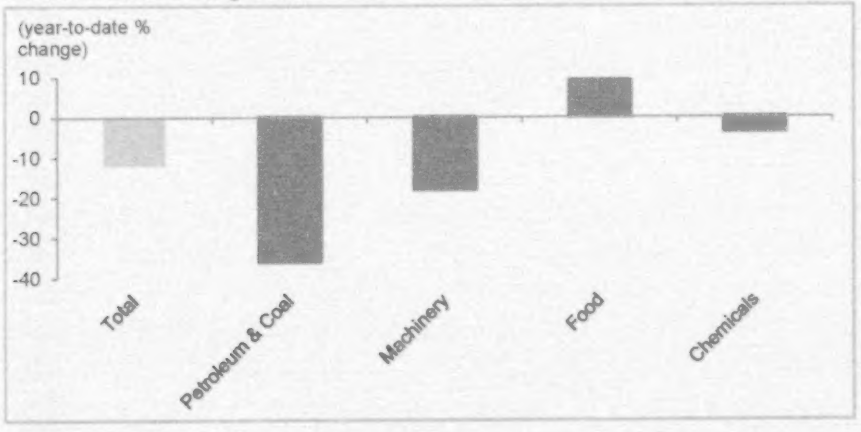
Record high Alberta oil production

Alberta crude production in August hit 3.2 million barrels per day, a 15% y/y increase and a new high. The gains were all in oil sands production. There was a 29% jump in synthetic crude production, while bitumen production was up 17% y/y. Due to the significant decline in rigs drilling, conventional oil production (-12.7% y/y) posted its third consecutive double-digit decline in August. Year-to-date, conventional crude production is down 7.8%.

Exports fall on lower oil prices

The value of Alberta exports fell again in August and September, after posting gains in the previous two months. Crude export volumes increased 13.2% YTD; however, exports values were dragged down by declining oil prices. Oil fell from US$59/bbl in June to US$45/bbl in September. Machinery exports have also fallen 17% YTD. Over the first three quarters of the year, exports are down 22%, mainly due to the declining value of energy exports.

Chart 2: Food manufacturing continues to expand amid broad-based decline
Alberta Manufacturing Sales



Source: Statistics Canada

Global Economy

IEA forecasts weaker oil demand

In their November oil market report, the International Energy Agency's (IEA) forecasts global demand growth for oil to slow to 1.2 million barrels per day (mbpd) in 2016 after growing by 1.8 mbpd this year. The IEA also estimates stockpiles of oil at a record 3 billion barrels. Inventory has grown even as the global oil market adjusts to the new lower price environment. The overhang that first developed in the US, has now spread across the OECD.

US economy strengthens

Third quarter US real GDP growth was revised to 2.1% from 1.5%. The revision was mainly the result of a change in inventories. The stronger growth comes after the US created 271,000 jobs in October. This was the highest monthly job gain since November 2014. The unemployment rate also continued its downward trajectory, falling to 5.0%, its lowest level since April 2008. The growth in the economy and strong labour market indicators have fueled speculation of a US interest rate hike at the next Federal Reserve meeting.

Global trade slowdown persists

The global economy has been sluggish since the Great Recession, leading to a slowdown in international trade. Growth in the value of trade for the global economy averaged over 7% annually between 2000 and 2007. Over the past five years, however, growth has slowed to an average annual rate under 4%. The International Monetary Fund currently expects global trade to expand by 3.2% in 2015. The slowdown has been especially tough for emerging markets, where export growth has fallen from an average of 11.2% per annum between 2000 and 2007, down to an expected 1.3% for 2015.

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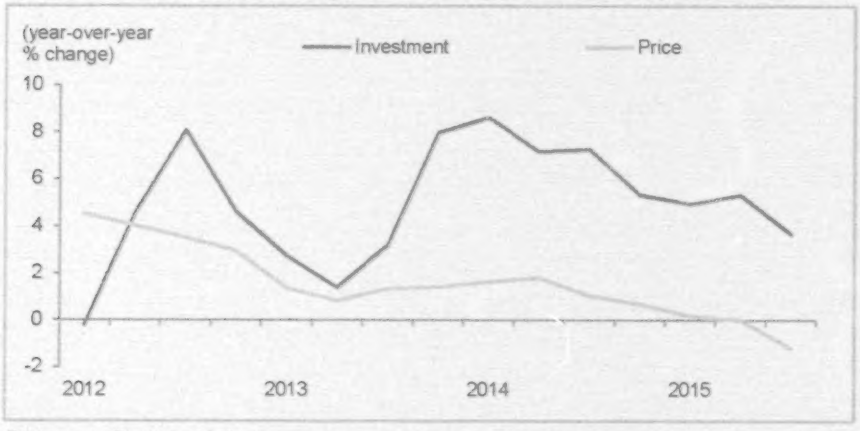
inFocus

Slowing economy keeps costs in check

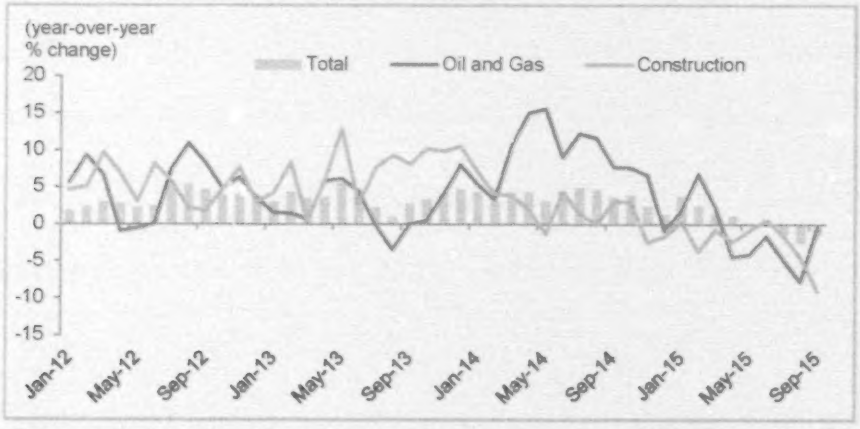
Alberta's economy is shifting down in the lower oil price environment. The energy industry has been hit the hardest by falling oil prices, causing sharp declines in investment. As a result, companies are pursuing cost-savings measures. Although investment in non-residential building construction is up 4.6% over the first three quarters of 2015, growth has slowed throughout the year, and construction costs were down over 1% year-over-year (y/y) in the third quarter (Chart 1). This month's InFocus explores the effect of Alberta's slowing economy on costs in the province.

Chart 1: Slowing activity and investment lead to lower costs
Alberta non-residential building construction investment and price index



Source: Statistics Canada

Chart 2: Earnings have weakened for industries closely tied to energy
Alberta average weekly earnings for select industries



Source: Statistics Canada

Slowdown in business activity

Economic activity has declined in the province. Manufacturing shipments have fallen 12% year-to-date (YTD). Excluding petroleum and coal, they are down 6.2% YTD. Reduced activity from lower oil prices and declining corporate profits has caused businesses to reduce capital spending. Energy investment has seen the sharpest decline, but non-energy investment has also started to weaken.

Labour costs decline

In the face of slowing activity and falling investment, earnings and hours worked have slumped. Average weekly hours worked has fallen 1.6% YTD. Overtime hours, which accounted for a large proportion of the decline in hours, are down in the oil and gas, construction, and professional and technical services sectors. The decline in hours has contributed to weaker earnings. Average weekly earnings growth has slowed to just 0.3% YTD, with some sectors closely tied to the energy sector experiencing declines (Chart 2). Oil and gas sector earnings are down 1.5% YTD, while consstruction earnings have fallen 2.5% YTD. Professional and technical services, such as architectural and engineering services, have seen earnings growth soften.

Costs starting to come down

Although economy wide cost indicators for the energy sector are not available yet for 2015, announcements by various energy companies suggest operating and constructions costs have fallen at least 5%, as companies implement cost reduction programs.

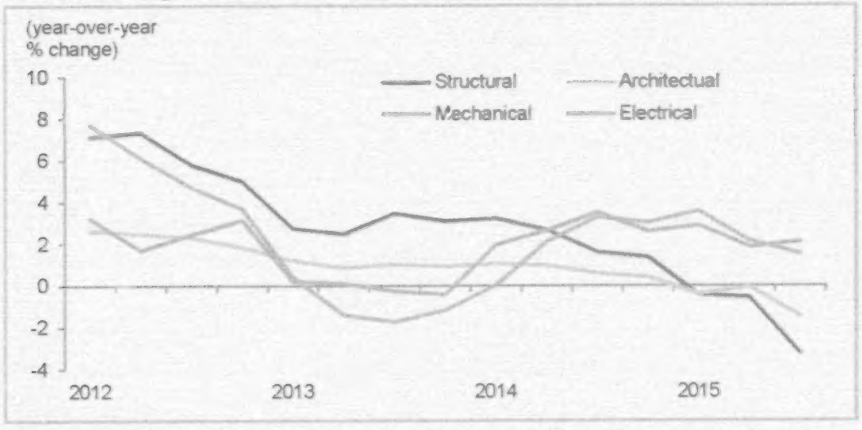
Construction costs for non-residential buildings were down 1.4% y/y in the third quarter of 2015, after being

unchanged over the first half of the year. This was the first decline, after averaging 2% per year over the past five years, There is, however, some divergence from where cost savings have been derived. Large project component costs (i.e. structural) have declined, while the cost of specialized services (i.e. electrical) has continued to increase (Chart 3).

Input costs mostly curbed

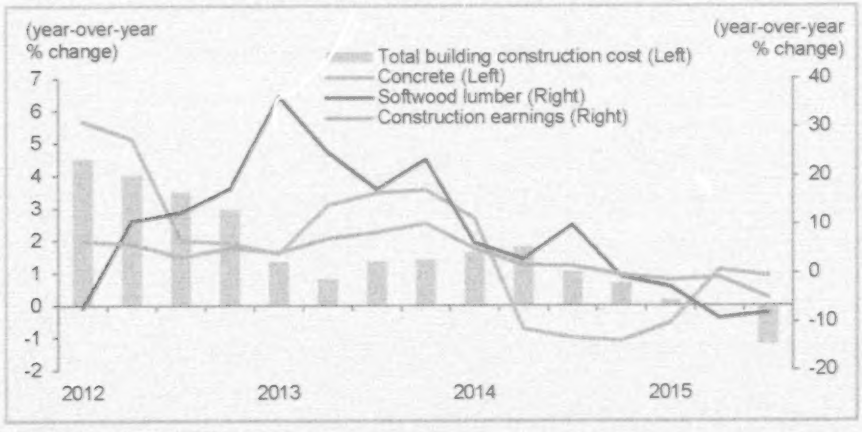
The cost of locally sourced products has declined due to the weaker economic environment. In the prairie region (not available by province), the price of softwood lumber, which is used in construction, has fallen 7.4% over 10 months in 2015 and the cost of cement has been contained (Chart 4). Gasoline and diesel prices have fallen by close to 30% so far this year, contributing to a decrease in transportation costs.

Chart 3: Divergence in project component costs
Alberta building construction project costs by project component



Source: Statistics Canada

Chart 4: Construction input costs are restrained
Alberta non-residential construction costs, earnings, & prairie product prices



Source: Statistics Canada

The cost reductions are evident in the new housing market, as the price of housing, excluding land costs, has declined by 1.2% since the end of 2014. Land costs, however, are still growing albeit at a slower pace than before.

Import prices rising

Price declines have not been homogeneous, however. The Canadian dollar has depreciated by 20% since the beginning of 2014. This has increased imports costs, which make up a large share of Alberta's expenditures. The price of machinery and equipment imports in Canada has increased by 16% over the first three quarters, with oil and gas extraction and construction import prices up around the same.

Consumers benefit from lower energy prices

While growth in earnings has weakened, the lower inflation environment has provided some relief to consumers due to declines in gasoline, natural gas and electricity prices. Alberta inflation has slowed to 1.1% over 10 months of the year, compared with 2.6% inflation in 2014. The decline in inflation was exclusiveiy due to energy prices, which were down 16% YTD. Consumers, however, are being hit by higher import prices. Prices for food, which is mostly imported, have increased 3.8% YTD.

Conclusion

In the current weak economic environment, companies are looking at various strategies to reduce costs. Presently, cost savings are being observed in energy, building supplies and labour, while costs are increasing for imported goods and services. Energy companies are also reporting substantial costs savings in their operating and capital budgets, while costs have begun to decline in other sectors.

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